

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

RME Illinois, L.L.C.)	
)	
Petition for Issuance of Certificate of Public)	
Convenience and Necessity to Provide Onsite)	Nos. 08-0490/08-0491
Wastewater, Collection and Dispersal Services)	(cons.)
to a Parcel in Lake Villa, Lake County, Illinois)	
Pursuant to Section 8-406)	
of the Illinois Public Utilities Act.)	
 RME Illinois, L.L.C.)	
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Petition for Issuance of Certificate of Public)	
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to a Parcel in Long Grove, Lake County, Illinois)	
Pursuant to Section 8-406)	
of the Illinois Public Utilities Act.)	

**REPLY BRIEF OF THE STAFF OF THE
ILLINOIS COMMERCE COMMISSION**

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NOW COME the Staff witnesses of the Illinois Commerce Commission (“Staff”), by and through their undersigned counsel, pursuant to Section 200.800 of the Illinois Commerce Commission’s (“ICC” or “Commission”) Rules of Practice (83 Ill. Adm. Code 200.800), and respectfully submit their Reply Brief in the instant proceeding.

Staff’s Initial Brief identified and responded to many of the arguments raised in the Initial Brief filed by RME Illinois, L.L.C. (“RME” or “Company”). In this Reply Brief, Staff responds only to the extent that the Company raised arguments that Staff did not adequately address in its Initial Brief. Staff has not altered its positions and arguments set forth in its Initial Brief and those arguments are incorporated and adopted as if fully set forth herein.

I. Discussion

Pursuant to Section 8-406 of the Illinois Public Utilities Act (“PUA” or “Act”) (220 ILCS 5/8-406), the Company is seeking two Certificates of Public Convenience and Necessity (“CPCN” or “Certificate”) to construct, operate, and maintain onsite wastewater, collection, and dispersal services (“Wastewater Services”) for two parcels of property located in Lake Villa, Illinois and Long Grove, Illinois (“Lake County areas”). The first Wastewater System is to provide service to the Falcon Crest Subdivision (“Falcon Crest”) in the Village of Lake Villa, Lake County, Illinois. The second Wastewater System is to provide service to the Eastgate Estates Subdivision (“Eastgate Estates”) in the Village of Long Grove, Lake County, Illinois.

Staff notes that the Company claims that only a public utility company can operate a Model 5 sewer system as discussed in the EPA Guidelines. (RME IB, p. 2) However, the Company has provided no evidence that cooperatives, municipalities, and mutually owned homeowners associations are prohibited from owning and operating Model 5 sewer systems.

A. Establishment of Proper Investment Level

Contrary to RME’s argument (see *Id.*, p. 7), Staff’s recommendation that RME invest the full cost of the backbone plant when the wastewater systems are acquired from the developers is consistent with the requirement in the Administrative Code (83 Ill. Adm. Code 600.370(a)) that “the utility will provide all supply plant (backbone plant) at its cost...” RME’s statement that “if the utility provides the entire investment in backbone plant then there will be nothing to refund to the developer” (RME IB, p. 3) is inaccurate. By virtue of RME investing the entire amount of backbone plant, RME will

refund that amount to the developer. The purpose of requiring RME to invest the full cost of the backbone plant to developers is to ensure that the utility has an adequate investment in the backbone plant. (See Staff Ex. 6.0, p. 5) Any concern that the developers are not contributing to the cost of the system is alleviated by Staff's proposal that the developers contribute the collection portions of the sewer systems in their entirety. (Staff IB, pp. 4, 6, 10, and 28)

Although RME cites Docket Nos. 00-0194 and 01-0645 in support of its proposed investment level and refund method, neither docket supports the Company's proposal. The Order in Docket 01-0645 is not applicable as it addresses main extensions rather than backbone plant which is the issue in this case. (Staff IB, p. 8) In Docket No. 00-0194, the Commission adopted Staff's position and found:

... Petitioner, by not providing refunds for costs advanced for sewer plant, will in this instance gain \$1,439,350 in sewer plant value without any corresponding investment. The Commission has no difficulty interpreting Section 600.370(a) as also pertaining to sewer supply plant to protect against the same unjust enrichment and to protect the same consumer interests as would result if refunds were not provided for water supply plant. To interpret Section 600.370(a) otherwise would permit Petitioner or any utility to amass sewer facilities entirely risk free, obviously frustrating at least part of the purpose for which this Section was enacted.

(Order, p. 6, Docket No. 00-0194, April 25, 2001)

Staff had argued that the Agreement at issue was unreasonable to the extent that it failed to provide for refunds to the developer for the sewer facilities as customers attach. (*Id.*, p. 4) Staff opined that in developing the appropriate level of refunds, it is necessary to consider that regulation is a substitution for competition. The purpose of a public utility is to permit a group of investors to make an investment in a necessary utility service, provide that service, and then recover reasonable operating expenses

and earn a reasonable return. While investors should be allowed the opportunity to earn a reasonable return, they should not be allowed to develop a system which enables a utility to amass significant assets with little or no investment by its shareholders. (*Id.*)

As there are no codified sewer rules, 83 Ill. Admin Code 600.370 is a reasonable surrogate. Staff's proposed investment level is based upon the Section 600.370(a) requirement that backbone plant be provided by the utility. (Staff IB, p. 6) RME's suggestion that the developer "should receive a credit (refund) from the utility equivalent to one-and-one-half times the Company's estimate of the annual wastewater revenues to be provided by "Original Prospective Customers"" (RME IB, p. 10) misapplies the rule. The concept of a refund of "one-and-one-half times the Company's estimate of annual wastewater revenue" comes from Section 600.370(b) and is applicable to main extensions, not backbone plant. (83 Ill. Adm. Code 600.370(b))

RME argues that receipt of the backbone plant through a contribution by the developer to RME will avoid undue risk for RME and its customers. RME states that under its proposal, if an area is not developing as planned, the risk is retained by the developer and "not imposed upon RME or its customers." (RME IB, p. 10) All of a utility's investment represents risk to the utility and its customer. Because of the cost of this project, the way to have avoided "undue risk" would have been to choose not to own and operate the systems at issue. RME's claim on this point is really an admission that it made a poor management decision.

RME argues that Staff's recommended investment level should be rejected because it results in rates that are in violation of the PUA. (RME IB, p. 11) Staff agrees

that the PUA requires that rates be just and reasonable. (See 220 ILCS 5/8-101, 9-101) The Commission is responsible for ensuring that a public utility does not exact unjust, unreasonable, and discriminatory rates. In this case, if the rates that must be set to recover the cost of the system are unreasonable, then by denying a CPCN, the Commission can prevent RME from “exacting unreasonable rates.” It is the responsibility of the utility to provide service that is reasonably affordable. RME is proposing a system that results in unreasonably high rates because of the small customer base.

B. Capability to Efficiently Manage and Supervise

RME’s argument that it is not obligated to comply with the PUA until after it has been granted a CPCN (see RME IB, pp. 18-19) is specious. The Company is seeking a CPCN to provide sewage services for public use. RME is a party to the construction of plant “to be used” by RME for the provision of the sewer service. Similarly, it is disingenuous for RME to state that it “is not a public utility company and therefore has no control of the actions of the developer who is operating under a permit, secured by the developer, from the Lake County Health Department.” (RME IB, p. 19) A CPCN is required before beginning construction of new plant. (See 220 ILCS 5/8-406) Construction began without a CPCN; thus, construction was not managed efficiently, or at least not legally.

The offer that “[a]fter RME is granted a Certificate of Necessity and Convenience... a complete and thorough inspection will be performed...” (RME IB, p. 19) is unhelpful. The time to supervise and manage construction is prior to and during

the construction, not after the fact. The promise of an inspection does not cure RME's failure to follow the law.

One reason that a Certificate must be obtained prior to beginning construction is to ensure that the public utility that is responsible for the presumed sewer system is capable of efficiently managing and supervising the construction process. It would be inefficient to allow public utilities to construct the facilities necessary to provide service prior to making the Section 8-406 determinations. Such a reversed approach could lead to the construction of poor quality systems and the denial of a CPCN. Illinois would then have sewer systems that could not be operated by any public utility because they had not been constructed properly. The suggestion that RME could not have controlled construction by the developer is without merit. The agreement between RME and the developer should have reflected the reality that a CPCN was necessary before RME could provide sewer service. RME's failure to comply with Section 8-406 requirements demonstrates that it is incapable of managing the sewer system.

C. Financial Capability

RME asserts its proposed investment methodology should be approved because it "is just and reasonable without any significant financial consequences for the utility or its customers." (RME IB, p. 12) Staff disagrees with RME for all the reasons set forth in Staff's Initial Brief (Staff IB, pp. 11-16) and recommends the Commission reject the Company's requests for CPCNs to serve the Lake County Areas because RME has not shown it has the financial capability to serve the Lake County Areas without significant adverse financial consequences to the utility or its customers.

RME opposes funding Staff's recommended level of investment and requests approval of a proposal in which utility investment occurs as new customers attach to the wastewater system. (RME IB, p. 14) RME vaguely asserts that all of the capital it needs will be internally generated and no borrowed funds would be required for purchasing, operating or maintenance of the wastewater systems that would serve the Lake County areas. (Staff IB, p. 12) Since RME has not specified where it would obtain the funds required to pay developer refunds, RME essentially argues the Commission should trust the Company despite the Company's refusal to provide any financial documentation and lack of experience operating as an Illinois public utility. RME has not addressed Staff's concerns regarding the Company's ability to fund the proposed construction without significant adverse financial consequences to the utility or its customers. Staff is not convinced that RME satisfies the requirements of Section 8-406(b)(3) of the Act and recommends the Commission reject the Company's request for CPCNs .

RME also argues that its proposed rate of \$53.30 per month "is just and reasonable and has no significant financial consequences for RME or its customers." (RME IB, p. 13) RME describes its proposal as follows:

The investment proposed by RME occurs as new customers are attached to the system. The per customer amount to be repaid to the developer is \$934 for Falcon Crest and \$963 for Eastgate Estates and funded as each new customer is attached to the respective system... The investment in the wastewater system is to be internally generated by RME. The predicted amount of internally generated funds in 2009 will be \$1926 based on 2 customers attaching to the wastewater system in Eastgate Estates. (*Id.*, p. 14)

However, Staff notes that if (1) the Commission grants the Company CPCNs such that the Company begins providing wastewater utility operations on July 1, 2009; and (2) on

July 1, 2009, two customers attach to the wastewater system (as projected), then RME would collect utility revenues totaling \$639.60 for 2009 (*i.e.*, \$53.30 monthly rate x 2 customers x 6 months). That is, RME would have approximately \$100 per month in utility revenues available to cover utility operating expenses. Furthermore, over six months, a rate base of \$1926, combined with a 10.82% rate of return, would generate operating income totaling \$104.20. Ignoring that RME failed to show it would have funds available to pay developer refunds during 2009, in six months, RME would not generate income sufficient to pay any developer refunds in 2010.

Moreover, this example underscores the importance of the Company obtaining a line of credit for at least \$35,000. Under Section 8-406(a), Ms. Phipps recommends RME obtain a line of credit so the Company will have a source of funds available to cover unanticipated expenditures because cash shortfalls could prevent RME from fulfilling its utility obligations under the Act. (*Id.*) Staff is not convinced that the five-year Letter of Credit between the developer of Eastgate Estates and the Village of Long Grove is a reasonable substitute for a line of credit. (*Id.*, pp. 14-16) Nonetheless, RME argues:

...a Letter of credit is a guarantee of payment by a bank in favor of a designated beneficiary class which is irrevocable and unconditional for a fixed period of time and given as security for proper system operation and maintenance. Staff witness Phipps failed to point out a line of credit can be revoked by a bank at any time, in contrast, a Letter of Credit which [sic] is irrevocable. (RME IB, p. 16)

Staff notes that lines of credit are not necessarily more easily revocable than letters of credit. That is, similar to a letter of credit, a line of credit may be established for a certain time period. Whether a bank may revoke a line of credit at any time depends on

the terms of the credit agreement, as established by the lender and agreed upon by the borrower.

Towards that end, in direct testimony, Ms. Phipps recommended, “[t]he Company provide Staff a copy of the \$35,000 credit agreement in rebuttal testimony, which would provide Staff a meaningful opportunity to evaluate the terms and conditions of the credit agreement.” Furthermore, she recommended that if RME could not provide Staff a copy of the credit agreement, then RME should provide a copy of the agreement and provide a letter of intent from an external lender for the line of credit that includes the following information: (1) name of the lender; (2) each and every borrower under the line of credit; (3) the amount (in dollars) of the line of credit; (4) a description of each and every condition to be attached to the borrowings under the line of credit; and (5) the anticipated date the Company will establish the line of credit. (Staff Ex. 3.0, p. 7) RME did not provide any of the information Staff requested.

In summary, Staff objects to granting RME CPCNs to serve the Lake County Areas because, in Staff’s judgment, the Company has not shown it is capable of financing the proposed construction or operating the utility without significant adverse financial consequences for the utility or its customers.

D. Sewer Rates

RME witness Olson stated in his Initial Brief that Staff witness Rukosuev supports Single Tariff Pricing. (RME IB, p. 12) This is a misstatement of Staff’s position. In direct testimony, Mr. Rukosuev stated that there is an alternative method to determine rates; however, Falcon Crest and Eastgate Estates revenue requirements should not be combined to determine a single rate that would be applicable to all

customers in this proceeding. (Staff Ex. 4.0, p. 4) Mr. Rukosuev stated in his direct testimony that combining the costs of Falcon Crest and Eastgate Estates would effectively transfer some of the costs of the Eastgate Estates system to the Falcon Crest customers who would get no benefit from the transfer. (*Id.*, p. 4)

In its Initial Brief, RME stated that “Staff witness Rukosuev testified that the rates he calculated using Staff’s revenue requirements are the rates the Company proposes.” (RME IB, p. 13) RME further stated that the rates recommended by Mr. Rukosuev are not the rates proposed by RME and are in violation of 220 ILCS 5/1-101(d)(ii) and (viii). (*Id.*) RME also implies that Staff’s recommended rates are too high. (*Id.*, p. 11) The above reasoning is misleading. In fact, Staff witness Rukosuev has calculated the rates in this proceeding based on Staff’s revenue requirement and Staff’s assessment of cost recovery for providing such a service. Thus, the rates recommended by Mr. Rukosuev were clearly not those proposed by RME; they are based on cost of service. The rates are high because the cost of service is high. The only reasonable approach in this proceeding is to apply Staff’s consistent across-the-board calculations which are based on Staff’s revenue requirement.

Staff objects to the RME analysis which resulted in a combined rate of \$53.30 because it would fail to provide the revenue requirement which would result from Staff’s recommended level of investment.

II. Staff’s Overall Recommendation

Because RME is not capable of efficiently supervising construction and managing operations and is not capable of financing the proposed construction without significant adverse financial consequences for the utility or its customers, Staff

respectfully requests that the Commission deny issuance of the Certificates as requested by RME.

Alternatively, if the Commission should grant RME the Certificates, Staff recommends a 10.82% rate of return on rate base and that the Commission order RME:

- a) To fund an escrow account in an amount equal to Staff's recommended investment, which funds are designated solely for utility purposes.
- b) To file a compliance report with the Chief Clerk and Manager of the Finance Department within 10 business days of establishing the escrow account, which includes the following information: (1) a copy of the escrow account agreement; (2) the name of each person and entity that contributed capital to the escrow account; (3) the amount (in dollars) each person or entity contributed to the escrow account; and (4) descriptions of each and every condition attached to the funds held in the escrow account.
- c) To obtain access to a line of credit from an external lender of at least \$35,000, which equals approximately one year of operating expenses (excluding depreciation and amortization) for the wastewater systems that would serve the Lake County areas.
- d) To file a compliance report with the Chief Clerk and Manager of the Finance Department within 10 business days of establishing a line of credit, which should include a copy of the agreement establishing the line of credit, the dollar amount of the line of credit and a description of each and every condition attached to borrowings under the line of credit.
- e) To file status reports on March 31, June 30, September 30 and December 31 of each year until the Company establishes the escrow account and a line of credit.
- f) To file actual accounting journal entries with the Chief Clerk of the Commission with a copy to the Manager of Accounting within six months of closing the transactions. If the transactions have not occurred within six months of the date of the order approving the petition in this proceeding, then the Company should file a report regarding the status of the transaction every six months thereafter until actual journal entries have been filed.
- g) To semi-annually report certain financial information for the new wastewater systems including, but not limited to, the aggregated plant investment, annual revenues, direct expenses, allocated expenses,

Contributions in Aid of Construction, and number of customers. The report should include an explanation of any significant changes in the status or operations of the systems. This will allow the Commission to determine whether the rates granted in this proceeding need to be reassessed.

- h) To retain the services of a certified public accountant familiar with public utility regulation in Illinois to set up the books for RME and advise the Company on matters of reporting to the Commission.
- i) To file the Rules, Regulations, and Conditions of Service tariffs for sewer service, within ten (10) days of the final Order, with an effective date of not less than five (5) working days after the date of filing, for service rendered on and after their effective date, with individual tariff sheets to be corrected within that time period, if necessary.
- j) To invest \$465,388 in the backbone plant of Falcon Crest and \$172,508 in the backbone plant of Eastgate Estates.
- k) To accept all collection plant as contributions from developers with no provision for refunds.
- l) To set rates at Falcon Crest for \$181.08 per month and \$297.34 per month at Eastgate Estates.
- m) To provide a copy of its bill form as a filed tariff sheet(s).
- n) To file compliance tariffs which will reflect an effective date not less than five (5) business days after the date they are filed with the Commission.

III. Conclusion

WHEREFORE, for the foregoing reasons, Staff respectfully requests that the Commission's order in this proceeding reflect Staff's recommendations.

May 8, 2009

Respectfully submitted,



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